RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

Since 1958 •

Post Office Box 1759, La Jolla, California 92038

26 Letters Per Year • $250 annually

Feb. 1, 1995 **LETTER 1166**

Jan. 20 DJIA 3869.43; PTI 3946; A-D Ratio -9.63
Jan. 27 DJIA 3857.99; PTI 3955; A-D Ratio -9.48
Dow Yield: 2.79%; Dow Price/Earnings: 15.4
Dow 200-day MA: 3778; Dow 30-day MA: 3810
Dow Times Book Value: 3.45; PTI 89-day MA: 3963
Percentage of Undervalued Blue-chips: 12%
Dow Low Risk Buy Index: -8; Gold-PTI: 689
Gold 200-day MA: 383.92

THE PICTURE: *"The only thing that has driven more men mad than love is the currency question."* -- Disraeli.

Bear markets like to strike in areas that are least known or understood by the investing public. One area that I have repeatedly drawn attention to is the area of currencies -- the dollar, the yen, the D-mark and the Swissie, and yes, even the peso.

In a bear market, the bear will produce whatever it takes to knock the market down. For example, so far this year fate (or was it the bear?) has given us the Orange County fiasco and the Mexican disaster. And oh yes, we also got rising rates.

The Mexican devaluation cast new doubts on the wisdom of NAFTA and GATT (and I wonder why Mr. Clinton has decided to beef up the Border Patrol at our Mexican border?). Some doubters are saying that the US proposal for a $400 billion line of credit to Mexico is just a disguised way of bailing out US banks and funds who have sunk billions of dollars into Mexico. But nah, that sounds too cynical to be true (yeah, right). See Notes & Quotes for more on Mexico.

Increasingly, the currency markets (i.e., FOREX or foreign exchange markets) are running the world's economies. No question about it, the FOREX traders are the new global vigilantes. Let a nation run its debts through the roof, let a nation provide all-out cradle-to-grave care, let a nation over-consume while forgetting how to export, and the FOREX crowd will knock its currency to its knees.

Today, the world's emphasis is on annual budget deficits and debt. And if you don't pass the test, you better defend your currency with serious budget cuts and higher interest rates. Right now the debt and deficit problems are hitting Spain, Italy, Belgium, Canada and a host of other nations. Furthermore, with every nation pushing for growth (in the face of **contracting global liquidity**) we have sliding stock markets, rising interest rates and very, very nervous politicians.

In the last Letter I outlined the twin pulls on the US stock market. The **bears** point to classic overvaluation, major divergence in the Averages, minuscule yields on the Dow and the S&P -- plus the fact that the Dow has not broken below a previous year's low for an unprecedented 12 consecutive years, and the added fact that there hasn't been so much as a 10% correction in the Dow in the last four years.

On the other side of the ledger, the **bulls** point to the fact that fifth years of the decennial pattern (1955, 1965, 1975, 1985, etc.) have always been good years as have third years in the four-year presidential cycle. With retail sales now slowing down, the bulls can also make a case (but perhaps a shaky one) for an end to Fed rate-raising (and therefore, an end to bond weakness).

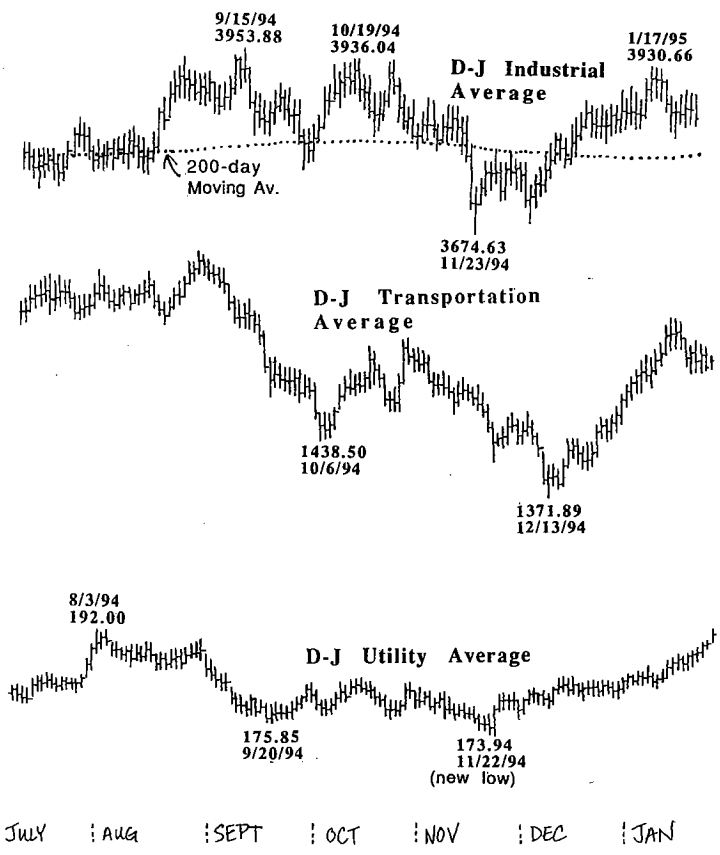
It would appear to be a Wall Street stand-off, with the consensus-bet being that the market is in an extended and tedious (but disaster-proof) trading range.

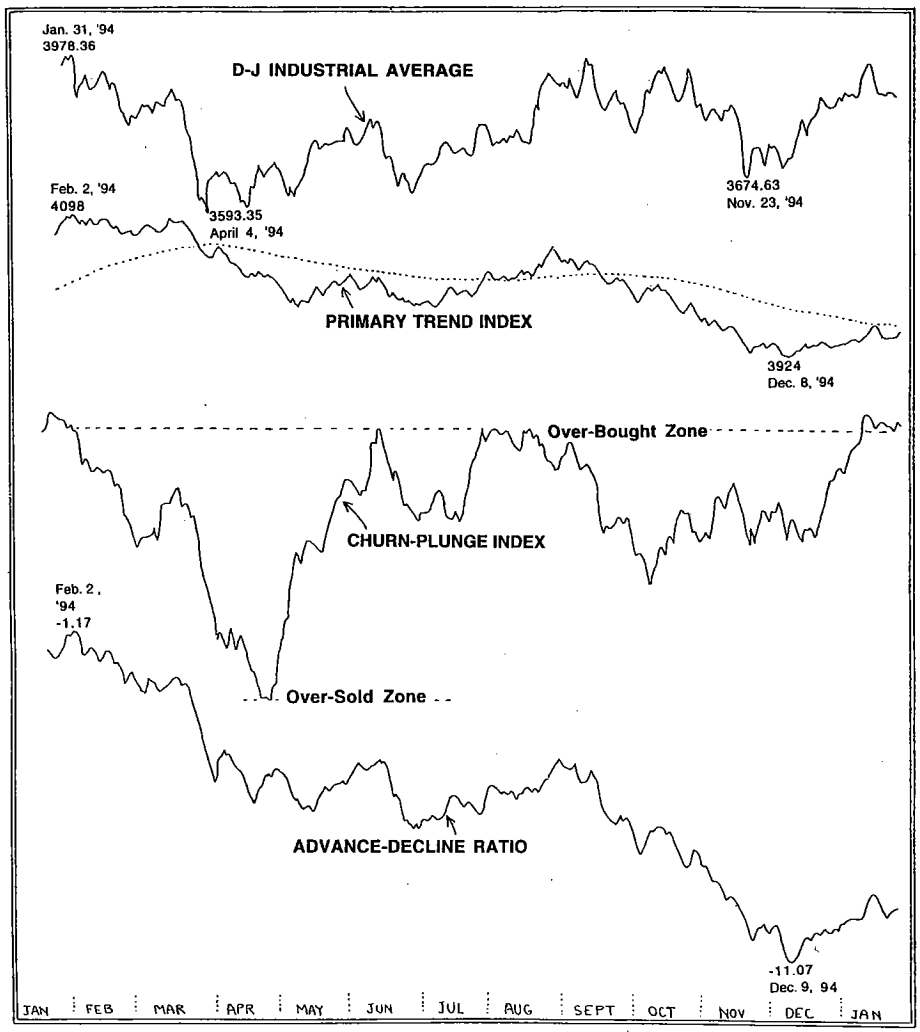
Is this the way Richard Russell would bet? I'm afraid not. This is a strange statement, but I've learned to take careful note of my own actions. What I mean is that I pretend I'm an outsider looking in. I take note of **what Richard Russell's actually done** vs. what he's "saying" or what he might "like" to do. In other words, I study my walk rather than my talk. And what I've done is to get clean of common stocks and into cash. So aside from being completely liquid, I've done nothing in the stock market -- zero, nada, naught.

Isn't this dangerous? Shouldn't you always have some participation in the stock market? Isn't that what all successful investors do -- in that they ALWAYS have some percentage of their assets in the stock market?

The answer is that I don't care what all those "successful stock pickers" are doing. Investing is a **percentage game**. And with the yield on the Dow down to a dangerously low 2.75% vs. the most attractive yield (5.7%) on T-bills in three-and-a-half years, I elect to go with safety and with the best return on my money.

Let me put it another way. The most powerful force in the market is the steady buying of informed, knowledgeable investment money. Informed investors don't like to buy when stock yields are well below 3%. History tells us that when average stock yields are below 3% informed investment money tends to sell rather than buy.





Question: Russell, you call this report Dow Theory Letters. OK, then why aren't you talking more about Dow Theory here?

Answer: I do talk Dow Theory, although newer subscribers may not be aware of it. The essence of Dow Theory is the recognition of **values.** The bulk of what Dow himself wrote about concerned values. Dow noted that stocks move in broad and extended waves that almost always end in extremes. The market runs to trends towards overvaluation (bull markets), then to trends towards undervaluation (bear markets), and then back to overvaluation again.

How the market and the Averages get to those opposing extremes, that's the part of Dow Theory that concerns itself with the three psychological phases, the action of the averages, the secondary corrections, divergences, lines, etc. But again I emphasize that the essence of Dow Theory has to do with stock values. Unfortunately, most of the "experts" that mouth off about Dow Theory have never taken the trouble to read Dow, Hamilton, Rhea or Schaefer. And that's unfortunate, since it results in an unending stream of blatant disinformation.

Question: Supposing the market remains in this so-called "over-valued area"? Supposing the market stays here for a matter of months or even for a year or more? In that case, are you suggesting that we just sit here and stare at our T-bill and money market funds?

Answer: There's nothing wrong with sitting and collecting 5-6% on your funds. And if our government is correct, if there's as little inflation as they claim, then what's wrong with 5.8%?

I remember back in the '60s when the "Magic Fives" (i.e., government bonds yielding 5%) were issued, it was said that "at five percent, the government would pull money from the moon." Investors loved a guaranteed five percent return back in the '60s. So what's so terrible about 5.8% now? And remember, 5.8% is better than **twice the yield** on either the Dow or the S&P 500.

TECHNICALS: Please refer to the chart at the top of page 2. The action of the Primary Trend Index (PTI) is self-explanatory. It rallied back to its 89-day moving average, then turned down.

The action of the advance-decline ratio is worth examining closely. From its peak on Feb. 2 at -1.17 the A-D ratio declined for nine months to a low on Dec. 21 at -11.07. During its decline the A-D ratio lost a total of 9.90 points. From the Dec. 21 low, the A-D ratio rallied to its high of Jan. 17. But the rally was rather unimpressive. At its January 17 high, the A-D ratio had recovered **a mere 15%** of its January-to-December losses. That told us that most of the stock losses of 1994 remain as losses. Which, unfortunately, is the way bear markets work.

The fourth line on the chart is what I call the "churn-plunge index." This indicator is a running sum of the last 25 days of breadth (it makes no difference whether the breadth figures are up or down). The churn-plunge index works as follows -- when the market is near a top, the daily advances and declines tend to be very close together (example, 1101 advances, 1088 declines). This type of action suggests that the stock market is "spinning its wheels." In other words, lots of action but very little progress. That kind of action puts the churn-plunge line near the upper zone, and it suggests topping action by the stock market.

Conversely, when the stock market heads down in earnest the daily declines rise precipitously while the daily advances shrink dramatically (example, 300 advances, 1500 declines). Such action generates high numbers on the A-D ratio, and as high numbers pile up on the 25-day totals, the churn-plunge index plunges. A text-book example of that occurred back in April when the index hit a downside extreme, an extreme that proved to be a bottom for the stock market.

Recently, in mid-January the churn-plunge line hit its highest level in a year. That told us that we were witnessing an extreme in churning action; it also told us that a top could be forming. How big a top? The churn-plunge line will not tell us that (and neither will anything else, for that matter).

Incidentally, there has been much puzzlement regarding the fact that breadth collapsed last year (1994) while the "big averages" tended to hold. This is from a piece from the *Barron's* roundtable (Jan. 16): "I keep hearing that there are a lot of stocks that have gone down a lot, where the damage isn't visible in the broad market averages. Well, here are some interesting numbers: on the NYSE, in 1969, before the start of the bear market, the average stock was down 18.6%. And yet the S&P subsequently fell 29.7%. In 1972, the average stock was down 21.2% from its high. Yet the S&P subsequently dropped 46.2%. In 1981, the average stock was down 14.2% from its high. The S&P subsequently sank 21%. In 1987 the average stock was down 17.8% from its high. The S&P subsequently went down 30%. And in 1990, when the average

stock was down 25.6%, the S&P subsequently went down 15.6%."

Russell comment: In 1994, as seen on the A-D ratio, the average stock was down substantially. Will the big averages follow? I wouldn't bet against it, and I suggest that you not bet against it either.

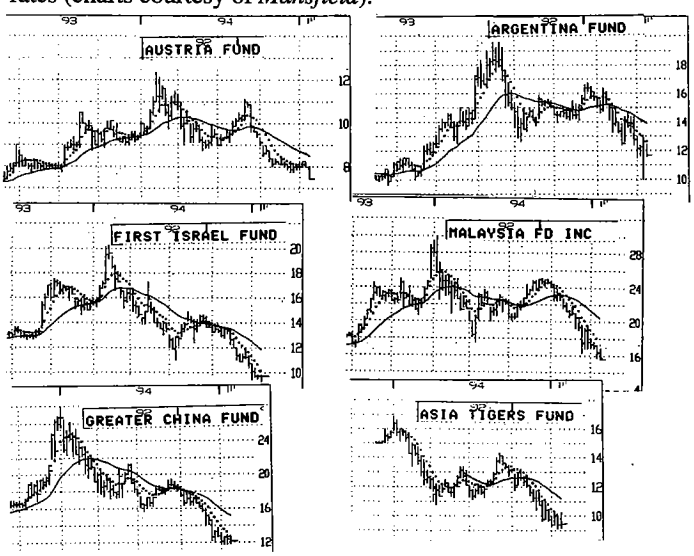
INVESTMENT POSITION: I'm not going to take up a lot of space in this section. Suffice it to say that the bear remains in the box. Even if you are trying to beat the bear, you might take special note of the position of the churn-plunge index (chart on page 2). You might also remember the record of the stock market when yields are low and T-bill yields are better than twice the yield on the Dow. In a phrase -- the record is not good. And the mutual funds -- they're multiplying like a bunch of sex-crazed rabbits.

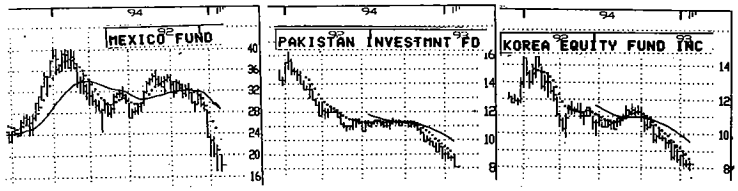
MAKING MONEY: Let's face it -- how many people do you know who have really made money in investing? You can probably count the number on the fingers of your left or right hand. What's the problem?

When real (inflation adjusted) interest rates are high, investors feel that they have attractive alternatives. High real rates allow investors to move into bonds or high-yielding money market instruments. You don't have to take too many chances in a high-interest rate environment where income is relatively easy to generate. A problem -- in a high interest rate environment rates are liable to go higher. Second problem -- when rates are rising a lot of your other investments are probably heading down.

The other side of the coin -- when real rates are low (as they were up to recently) people get "itchy," they fret, they want income, and therefore they are therefore impelled to take risks. It was, I believe, this urge to "generate income," to "take risks," that drove so many funds and investors and speculators into the so-called developing-nation markets, the "hot" Asian and Latin markets, the Mexican market, and even into the lesser known and "cat-and-dog" stocks.

But as rates began to move up again the slaughter began. Orange County, the peso, Hong Kong, China, the "attractive" foreign markets -- and the results were little short of disaster. I'm including below a sprinkling of the once very popular closed-end country funds. This will give you an idea of what's happened to some of the mountains of money that went searching for big profits, big profits that they hoped would make up for prevailing low interest rates (charts courtesy of *Mansfield*).





All of which brings me to the subject of losses. Most people don't realize it, but the most important single thing you can do in investing is to **avoid losses.** Losses kill. Investing is a game of percentages. One simple formula tells the story. If you have a $100,000 portfolio, and you lose $50,000 that represents a loss of 50%. But -- to get back to $100,000 again you have to show profits of 100% (and that doesn't include taxes on your profits, so you really have to do better than 100%). That should show you the danger in suffering big losses. Take a big loss like say 50%, and you may never get back to where you were.

Occasionally, a subscriber will tell me, "Russell, you're too darn conservative. Yeah, maybe you're right that this is a bear market, but there are always certain stocks and certain sectors that are going up. Why not concentrate on those? C'mon, stop being an old fuddy-duddy."

I tell them that in a bear market it's certainly possible to make money (just as it's possible to beat the slots in Las Vegas) but the odds are against you. Keep trying to beat the bear, and you'll find out to your sorrow that the bear will end up beating you (in the same way that the casinos will). In a bear market you're playing against the odds and against the probabilities. And if you keep playing you'll end up a loser.

Do you want to make money and end up pleasantly comfortable or even wealthy? Then you must avoid the losses, particularly the BIG losses. Every successful investor, speculator and trader knows this -- if you want to stay in the game you must (1) make money, show profits, or (2) not lose money or at least keep losses at a minimum. To put it succinctly, **"you've got to make it or not lose it."** If you can do that, you'll do very nicely in this business.

I've followed that basic principle ever since I started investing back in the '40s. And it's served me well. Put that together with the twin concepts of (1) **staying out of debt,** and (2) **compounding** your money, and you're bound to end up with more bucks than you can spend.

Recently, I talked to a man in NYC whose business entails dealing with literally hundreds of advisories and investment letter writers. I asked him how the industry was doing. He said, "Terrible, business has been lousy." He asked me how I was doing I said, "Same as last year, my business is as good as it's ever been."

I'm not writing the following in the form of a boast. I'm writing it because I want to get something across to my beloved subscribers. I think the reason business has remained good with me is because I sincerely try to teach readers how to make money OR how not to lose it. I don't publish long lists of "stocks to buy" when it's a bear market. I don't boast about being a "number one market timer" (whatever that is), and I don't advertise with such headlines as "Are We On the Edge of a Boom or a Bust?"

I know that the majority of people who are holding stocks or are speculating in this early stage of the bear market will lose their money. And I say as much. Furthermore, I realize that it's boring and frustrating to play it safe for months on end during a bear market -- but that's what I believe our position should be, and I say so.

I also put a lot of emphasis on the big picture, which is the really the critical picture for investors. The BIG picture is that at all times we're either in a bull market or a bear market. Ignore that little fact, and you're on your way either to be left out in a era of big potential profits or to be in stocks in a period when the bear is intent on putting you on the welfare roles.

So here are my rules: (1) Know what kind of a market you're in, bull or bear. (2) Stay out of debt. (3) Compound your savings (and you can't do that if you're in debt). (4) Avoid losses (and I'm talking about the big losses). (5) Learn to be patient, very patient. Remember, the markets don't care about you, they owe you nothing.

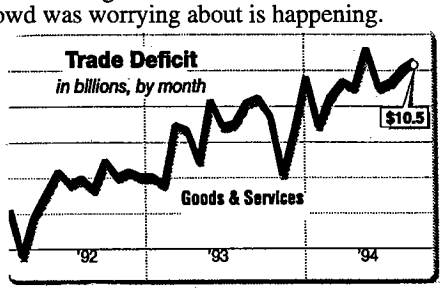
NOTES & QUOTES: Clinton's State of the Union speech lasted over 80 minutes. It was the longest State of the Union speech by any President in history. My, how that man can talk. Clinton used the phrase, "New Covenant," to counter the GOP's "Contract With America." In fact, Clinton must have used the word "new" about 300 times. Nu, nu, nu. And with all their complaining about taxes, why don't the Republicans talk about canceling the Bush tax boost or the massive Clinton tax boost? Talk, talk, talk.

* *

In his latest report, Martin Zweig notes that the National Association of Purchasing Manager's Commodity Price Index has jumped to 80.3, a 15-year high. Marty states that (1) in the past when the Index got this high inflation accelerated, and (2) when the Index was 80 or better the stock market did not fare well -- as in 1966, 69-70 and 1973-74.

* *

The US trade deficit is heading for over $150 billion for the year -- on its way to posting its worst reading in history. We've got trade imbalances almost everywhere, from Japan and China to Western Europe and Singapore, Hong Kong and Taiwan. Oh yes, then there's Mexico. Get this -- the latest figures show a jump in our trade deficit with Mexico from $89 million in October to $378 million in November. Get ready for an ever-increasing flood of goods from low-wage countries. What the anti-NAFTA and anti-GATT crowd was worrying about is happening.



* *

The GOP is talking about passing no less than four amendments to the Constitution. Among them school prayer, a balanced budget, term limits. They won't be easy to pass. Since the Constitution was founded, lawmakers have proposed 10,000 Constitutional amendments, but only 33 have passed Congress, and of these only 27 have been ratified by the states.

Did you know that the Supreme Court called the **income tax** unconstitutional, but the 16th Constitutional amendment allowed for this tax. Personally, I still have grave doubts about the right of the government to take away the earnings of one person and distribute it to another. By the way, from what I gather the 16th amendment was never properly ratified by the states, and many tax protesters use this as their defense.

Which brings me around to a pet peeve. I believe every American should study the Constitution. Ask 19 out of 20 people basic questions about the Constitution, and they don't know what in the world you're talking about. And this ignorance is the main reason why and how politicians have bypassed the Constitution and turned the US government into a monster, mega-spending, meddling bureaucracy. In order for a democracy (or a republic, if you wish) to survive, it must have an informed electorate. The 1994 electorate was not informed, but it was burning mad. That resulted in the recent election turnabout, but anger is not enough. It's imperative that the people know the Constitution, which is the supreme law of the land (and by the way, just in case you weren't aware of it -- the Supreme Court does not make our laws, Congress does).

* *

It gets worse and worse for Euro Disney. The stock came out at $31 in March of 1992. A few weeks ago the stock was excluded from the Paris bourse's blue-chip CAC-40 Index, and Euro Disney stock then dropped to $1.95.

* *

I received an angry raft of letters from Canadian subscribers correcting the table (last Letter) on Canadian capital gains. It seems the cap gains tax in Canada runs around 35%. A subscriber writes, "In Canada both long and short term gains are treated the same . . . These tax levels are actually confiscatory in effect: the underground economy swells, tax revenues decline so finance ministers raise (!) tax rates. We will see the Canadian peso devalued soon, if politicians don't do something about expenditures -- and they show no intention of doing so." RGN, Toronto.

* *

I was lucky, as a season ticket holder I won the lottery and got two Super Bowl tickets for the face price of $200 each. I wasn't ready to fly to Miami, so I sent employees Lynn and Pam there to root for the Chargers in my absence. I guess they didn't root hard enough. The game was a blow-out. But at least it showed where the Chargers need improvement -- just about everywhere. As for me, I bet the 19 point spread on the Chargers. Very bad bet, but it serves me right for betting.

* *

Webster Hubbell, until recently the number three power in the Justice Dept., is causing the Clintons and friends to sweat a bit. Hubbell was a partner in Hillary's law firm, and Web knows what was going on. Hub has pleaded guilty to overcharging clients, and has now copped a plea. In the plea bargain the operative phrase was that Hubbell agrees "to cooperate by providing full, complete, accurate and truthful information concerning matters under investigation by the office of Independent Council." If the Council asks the right questions of Hub -- we could have some "legal nuclear bombs." And the Clinton's could have quite a bit of explaining to do.

* *

The burning desire to "keep Mexico afloat" via $40 billion in US loan guarantees -- that desire is fizzling out, and politicans are having second and third thoughts about the whole picture. What stopped the pols? It was public opinion plus the realization that the bailout was really a bailout of the US corporations, banks and funds who foolishly invested multi-billions of dollars in Mexico on the thesis that a south-of-of-the-border investment would turn out to be a pot of gold. Furthermore, we now know that Mexico all along planned to devalue the peso -- just as soon as Washington passed NAFTA.

As for Mexico, its external debts have burgeoned to $30 billion, mostly owed to US banks. The debt is denominated in tesobono bonds, which must be paid back in pesos -- but pesos pegged to dollars. With the peso's collapse, the Mexican government's obligations on these bonds has soared. Have fun, guys.

* *

Angry voices are now asking why the US is bailing out Mexico while Orange County in California is allowed to drown in its debt. I tell them it's all politics. If Orange County goes under, it's not Clinton's problem. Clinton never pushed a NAFTA for California. But if Mexico falls apart, then the anti-NAFTA crew will be all over Clinton.

* *

Sports. Football has become BIG, BIG business. The lowly Tampa Bucs just sold for an astronomical $192 billion (they were originally bought for $16 million). Now the LA Rams are headed for St. Louis (assuming the NFL accepts the deal), and the goodies for the Rams are amazing. A new $250 million stadium complex. A state-of-the-art practice field. St. Louis to pay off the $30 million that the Rams owe to Anaheim. St. Louis also to provide $15 million in moving expenses plus any law fees if the deal goes to court. And St. Louis fans are being asked to buy 40,000 licenses (for seats) at $250 to $4,500 a piece. The deal is said to be worth $20 million a year for the Rams. Now if the Raiders leave LA, the second biggest market in the nation will have no NFL team. Nah, it will never happen, the NFL won't allow it -- or will they?

* *

Showtime: good news -- Robert Redford and execs from Showtime just announced that they are forming a new cable channel which will show independent films, foreign films, top films which have not been distributed and documentaries. This has

long been needed. There are literally hundreds of fine films that are never seen. My brother-in-law ("Vision Associates" in NYC) has been making outstanding documentaries films for 30 years, and many of his films have never been seen on public TV. Go Redford, you're doing us a great service.

* *

How'd the movies do in '94? Here's the rundown straight from my Jan. 17 issue of *Variety.* "'The Lion King" was the big winner with almost a third of a billion dollars in gross receipts. Disney will miss Katzenberg.

The Lion King (BV)**	$298,879,911
Forrest Gump (Par)**	298,096,620
True Lies (Fox)	146,260,993
The Santa Clause (BV)**	134,560,221
The Flintstones (U)	130,522,921
Clear and Present Danger (Par)**	121,715,132
Speed (Fox)	121,248,145
The Mask (New Line)**	118,644,781
Mrs. Doubtfire (Fox)*	107,430,221
Maverick (WB)	101,631,272
Interview With the Vampire (WB)**	100,006,085
The Client (WB)	92,115,211
Schindler's List (U)*	91,077,929
Philadelphia (Sony)	76,878,958

* *

What about dear old **42nd Street** in NYC, part of the "Crossroads of the World?" When I was a teenager that's where we used to sneak in to see the burlesque shows (at the Gaiety Theater or at Minski's). Around the corner at the Paramount Theater we could catch Tommy Dorsey or Benny Goodman or Frank Sinatra plus a new movie and all for 75 cents before 12PM; after 12 it was a fat $1.25. Forty-second Street is where we could buy a malted for a nickel -- in fact, it was where you could buy just about *anything* if you had the bucks. But now NY wants to clean up 42nd Street, and Disney has announced that it will spend $34 million to renovate the Amsterdam Theater. Disney wants to use the 92-year old theater (former home of the Ziegfield Follies) for its own productions. Ah well, I'll miss the old 42nd Street, but the place I really miss in NYC is 52nd Street. In the '40s that street was lined with jazz joints, and Kelly's Stable was my favorite. There, for a 60 cent beer you could see the greatest jazz musicians of the era including Roy Eldridge, Coleman Hawkins, Billy Holliday, Ben Webster. Honestly, when 52nd Street went blank NYC lost a lot of its lure for me.

* *

Oil: In 1994, the first time ever, the US used more foreign oil than domestic. The US brought in almost 8.9 million barrels a day in '94, 50.4% of the total -- while US oil production sank to a 40-year low. Thus the US is depending on one of the most unstable areas of the world for the bulk of its oil. If I had to buy one equity at this time it would be Royal Dutch. If pressed to buy another, I'd buy American International Group (reinsurance).

* *

Progress: China reports that in December their inflation rate dropped from 27.7% to 25.5%. At the same time Russia reports that its GDP declined in '94 by 15%.

* *

Cuts: With all the talk of a bullish cut in the capital gains tax, Michael Metz (senior strategist, Oppenheimer, and a very smart guy) differs. He says, "My view is that a completely opposite inference is warranted. In the background is the enormous buildup of wealth among the baby boomers who created companies in the post-war era. Unfortunately, the logic would be compelling for company owners to liquefy their accumulated wealth through public offerings of shares once the capital gains tax cut is put into effect. After all, the prospective tax cut is more likely to be seen as the opportunity of a lifetime to take advantage of a low rate."

* *

The most important act of the new "Republican Congress" on opening day was to change House Rule XXI. In doing so, they abandoned the old requirement that just a simple majority was needed to approve an increase in individual and corporate tax rates. It will now require a three-fifths vote to raise taxes. If this rule had been in place earlier, the infamous 1990 deal in which Bush agreed to raise taxes never would have passed -- and Bush might well have been re-elected.

* *

Speaking of taxes: House Majority Leader Dick Armey's flat tax was slated to be incorporated in the Republican's '96 election platform. Now there's talk of speeding it up and maybe passing it before the election. But Ways & Means Committee Chairman Bill Archer would prefer a consumption tax, and this is where the big argument may lie. **Russell comment**: I'd rather have the consumption tax, but I would take either the consumption or the flat tax in a second, rather than the current outrageous mish-mash of taxes. Sweeping out the current tax system fits right in with the GOP's anti-corruption and anti-bureaucracy program. Do it, guys, do it.

* *

Oops: As for the term-limit part of the Contract With America, there's some trouble. Not all the Republicans like this one, and a lot of Dems don't like it either. There is also disagreement on how long term limits should be for. Gingrich wants 12 years for House members and the same for the Senate, but the length of terms, it seems, are up for grabs.

* *

The cover of *Time* magazine, January 23, got my dander up. It was headlined, **"Is Rush Good for America?"** Listen, anybody who tells the truth is good for America. And anybody who lies or is secretive is bad for America. I like Rush Limbaugh, he's funny, he's smart, he's entertaining, he's a terrific actor, and he does tell the truth. Rush either exposes or makes total fun of the liberals, which, of course, has them fuming. Actually, the various radio talk shows were (in my opinion) largely responsible for the demise of the Democrats. People have been reading the liberal press for decades, and were unable to hear the other side of the story. The radio talk shows gave the American public the other side, and Rush, with an audience of 20 million, was a huge factor in the Dems defeat. Is Rush Limbaugh "Good for America"? I can tell you one thing -- he's hell on wheels for Clinton and the liberals. Which suits me fine.

* *

Al D'Amato, the tiger of the Senate Whitewater hearings, has turned pussycat and has agreed to postpone indefinitely hearings on the Clintons' involvement in Whitewater. Actually, the Repubs are satisfied with the way independent council Ken Starr is going. But probably more important, the GOP doesn't want Whitewater to blow Clinton out of office. As William Safire of the *NY Times* puts it, "They don't want to strike down Clinton's presidency. They want him right where he is so they can run against him."

* *

Second thoughts on the Balanced Budget Amendment. The problem is that if the federal government moves to balance its budget, the feds will have to cut out roughly $340 billion which goes to the various states. Examples: California would lose $10.6 billion in federal money slated for Medicaid, welfare, and education and the state would then have to raise taxes by 12.6% to make up for it. New York would lose $11.2 billion and have to raise taxes by 23.8%. Remember, I've said repeatedly that when a nation is living off a billion dollars a day in deficits, there's no way in the world that you can cut out those deficits without experiencing extreme pain. Will the nation and the pols take the pain? We'll see.

* *

CalPERS, California's huge $80 billion public retirement fund, is moving from 49% in equities to 63%, which representing an $11 billion swing out of money instruments and into stocks. Their object -- higher long-term returns. One thing's for sure -- CalPERS doesn't read Dow Theory Letters, or if they do, they don't take it seriously. Let me put it another way -- when the S&P yields 2.8%, history tells us that it's not the time to buy stocks for "long-term returns."

* *

I'm again flooded with letters, newspaper clippings, article, books, and my problem is -- I can't answer all this correspondence. So don't think I'm an ungrateful curmudgeon if I don't respond to your letter. It's just that I have a limited amount of energy, and I feel that I should devote that energy to writing Dow Theory Letters. However, I do appreciate all the comments and particularly the information. As for questions, I try to answer them in these reports. Hey, I'm trying.

* *

A few Letters ago I explained why we didn't send out Christmas cards this year, and my story was that my wife, Faye, was too busy. Whereupon I received about 20 letters from subscribers (mostly women) asking why the devil I didn't send out the cards myself. OK, here's my excuse -- I usually draw a cartoon Xmas card but Faye said no, this year she wanted to send out a "normal" Christmas card. So weeks passed, and it got too late for my cartoon, and Faye was too busy to get around to buying the normal cards - - so there, that's my excuse. But next year - -

I just received the *Gambler's Book Club* catalogue out of Las Vegas and some of the book titles are pretty amazing. A sampling -- "Casino Craps is a vicious $$ Devouring Game," "The Body Language of Poker," "Chip-Wrecked in Las Vegas," "Cheating At Blackjack and Other Casino Games," "Kinky Handicapping," "Hand Mucking, the Art of Switching Cards in Play," "Another Heart in His Hand," "The Book of Risks."

* *

A couple of million kids live in California. I checked the list of 41 finalists in the famous Westinghouse Science Talent Search. Of the 41 kids hailing from all parts of the nation, an unbelievable three came from one school in California. Here's the list. And, by the way, La Jolla High is a public school (one of my kids goes there now and another will be there next year).

These are the finalists in the 54th annual Westinghouse Science Talent Search:

California

Franz Edward Boas, 17, San Diego, La Jolla High School.

Irene Ann Chen, 17, San Diego, La Jolla High School.

Elaine Wei-Yin Yu, 17, La Jolla, La Jolla High School.

GOLD: *It is observed of gold that to have it is to be in fear, and to want it is to be in sorrow* -- Samuel Johnson (1709-1784).

Gold has had every opportunity to surge higher on the collapse of the peso and the severe decline in other assorted currencies. It hasn't done it. On the other hand, with the government's low inflation figures as per the CPI and PPI (although I'm not sure I believe either), gold has had every opportunity to break down to the critical 368 level. It hasn't done it.

I think the probabilities are high that gold has bottomed. The bearish sentiment towards gold is stifling. The gold stocks have been hit hard and holders of those stocks are worried. My local coin dealer gives me a pained look when I ask him if anyone is buying gold coins. Nobody, it seems, wants gold except the ladies and gentlemen who lust for jewelry.

Of course, our friends south of the border would have loved to have held gold instead of what's left of the peso, but it's a bit late for that kind of wishful thinking. The paper peso has done a swan dive as have many of the Latino currencies. C'est la vie.

It's beyond coincidence -- with all kinds of eruptions, problems, troubles in the currency markets, with the peso diving, with the $400 billion bailout bill for Mexico in doubt -- gold, suddenly, on January 24 plunged four dollars. C'mon, don't tell me that the world's central banks (and, of course, the Fed) aren't watching gold like a hawk, and when gold pushed above 380 to about 384 -- wham, they hit the metal, dropping it back to just above 380.

Is it any coincidence that gold's 65-week moving average (its most important moving average line) is at 382, and that when gold rallied above 382 to 384, that's exactly where it was knocked down? My view -- with talk of devaluations everywhere, the last thing the Fed wants to see is gold advancing strongly above the mid 380s.

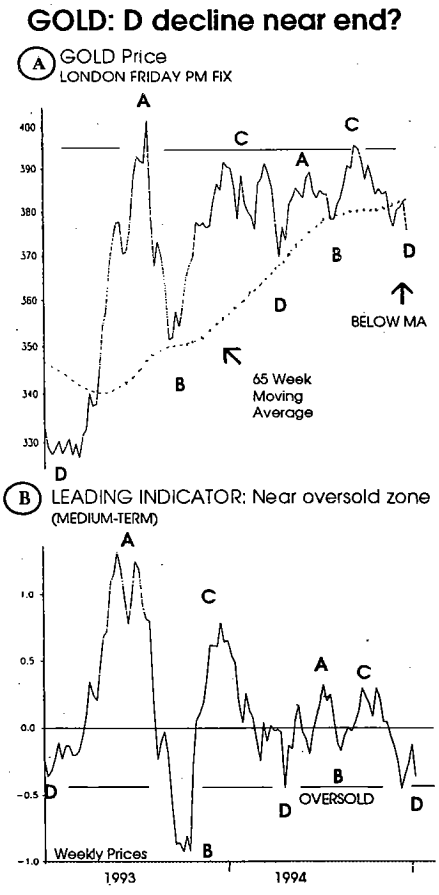
But OK, let them manipulate the metal. The more they knock it down, they more it is held back, the more powerful the move will be when gold's primary bull trend finally takes hold. I've seen these kinds of "corrections," pull-backs, whatever you want to call them, in gold and in dozens of other items. The pull-back just makes the item that much stronger, that much more bullish. Rising gold is a red flag for paper money. Thus, the central banks are scared to death of even the thought of surging gold.

I'm including here the Aden sisters chart of gold along with their rate-of-change index for gold. The Adens have studied gold for years (I know these ladies well, and they are experts on gold), and the Adens note that gold moves in A-B-C-D patterns and then back to A. They conclude that gold is either finishing up its D (down) leg or has actually completed its D leg.

The next move would be the bullish A leg. Based on the fact that gold is near to or actually in the oversold area, the Adens think that gold is ready to climb. The bullish signal for gold would be advancing above 382, holding stubbornly above 382, and then pushing up from there -- preferably above 390. (*Aden Forecast,* PO Box 84905, Phoenix, AZ 85071). The Adens live and write from lovely Costa Rica, but their mailing address is as above.

I've been asked what the problem with the gold stocks is. The problem is that the stocks price as a multiple of gold's price. Ian McAvity of Canada keeps a record of the Toronto gold average times the price of gold. At the low end, when the gold shares are a bargain, the gold average can sell as low as 3.5 times the price of gold. But when the stocks are expensive, they can sell as high as 22 times the price of gold. And the gold stocks are at the very high end of the multiple now. Conclusion: the stocks are not going to move up unless gold moves up substantially. So far, that's just not happening.

Interestingly, the "commercials" (the large commercial users of gold) have now taken a major position in gold contracts while the speculators and small traders are short. This is a bullish combination, and should militate towards higher gold prices. It certainly suggests that the 375 level will hold on any further weakness.



NEXT MAILING: Feb. 15, 1995

LATE NOTES: US Factory operating rates are high -- above 85% and the Nat. Assoc. of Purchasing Managers price index is at a very high 87%. This combo has always meant a rising Consumer Price Index. On top of this the Philly Fed mfg. price index has climbed to a two year high. But on the other side, M-2 growth is at a lowly 1%.. And in the background, US and world liquidity is being sqeeezed. Finally, gold acts as if deflation and declining liquidity are the real, longer-term problems.

Meanwhile, the stock market churns; huge amounts of volume are being expended in order to produce each upside Dow point. Study the PTI (page 2 chart); it barely budged higher during the latest stock market rally. A weak PTI during a market rally is not a good sign. . . With the loan to Mexico in grave doubt, the Mexican situation becomes extremely critical. And the dollar turns WEAK.